BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE FORMAL COMPLAINT OF THOMPSON SCHELL, LLC AGAINST TIDEWATER UTILITES, INC. REGARDING CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION ("CIAC") (FILED ON JULY 10, 2020)	)))))	PSC DOCKET NO. 20-0434

ORDER NO. 9695

AND NOW, this 12th day of May 2021;

WHEREAS,

1. Thompson Schell, LLC ("Owner") is a Delaware is a limited liability company which is in the process of constructing residential homes in Sussex County, Delaware. In 2016, Owner began construction on its new 253 single-family residential development, called Woodfield Preserve. There are multiple phases 1-4 to Owner's development, with homes sold and some occupied. The site work and infrastructure are targeted for completion and the project is entering into phase 4.

2. Tidewater Utilities, Inc. ("Tidewater"), having secured a Certificate of Public Convenience and Necessity for the property, in 2006 had entered into a water services agreement with Owner for the Woodfield Preserve development.

3. On May 6, 2020, the Owner received a payment invoice from Tidewater in the amount of $ 75,016.93 representing Tidewater's tax liability related to contribution-in-aid of construction ("CAIC) Tidewater had received from Owner in connection with the Woodfield Preserve development. The demand for payment included an issuance of "Stop Work Notice" if payment was not tendered within 30 days. Owner disputed Tidewater's invoice

and argued that it was not required to reimburse Tidewater for its tax liability with respect to the CAIC.

4. Negotiations between the parties to resolve the dispute were unsuccessful. At that point, the parties agreed that Owner would escrow the invoice amount pending a decision by the Commission as to the question of Owner's liability for Tidewater's CAIC tax liability for the Woodfield Preserve development. (Although not directly in dispute at the current time, the parties understand that the resolution of the issue of Owner's liability for the CAIC tax "gross up" for Woodfield Preserve likely could also affect three (3) other similarly-situated developments of Owner for which there are similar WSAs in place from 2006 - Marine Farm, Oak Creek and The Preserves at Jefferson Creek.

5. In connection with the parties' agreement to seek the Commission's decision with respect to the issue of the responsibility of the tax liability related to the CAIC, the parties agreed that Owner would promptly submit a formal complaint to the Commission, Tidewater would respond and thereafter the parties agreed to a two round briefing schedule together with a set of agreed Revised Stipulations.

6. Following the filing by Owner of the Complaint, the Answer by Tidewater and the intervention by the Division of Public Advocate, the Executive Director, on August 5, 2020 appointed Mark Lawrence as the Hearing Examiner in this matter pursuant to Rule 2.5.2 of the Commission's Rules of Practice and Procedure (26 *Del. Admin. C.* \$1001-2.5.2) charging him with conducting the proceedings that he deems necessary to develop a full and complete record and to then file a report with his proposed findings and recommended decision. Then, on March 10, 2021, the Executive Director withdrew the appointment of

Mark Lawrence as Hearing Examiner in this docket and appointed Glenn C. Kenton as Hearing Examiner.

7. On April 8, 2021, Hearing Examiner Kenton, having duly considered the arguments of all parties in this Docket (Staff did not participate in the Docket), filed with the Secretary of the Commission his Findings and Recommendations with respect to the Complaint and Answer. A copy of the Findings and Recommendations of the Hearing Examiner is attached to this Order as Exhibit "A."

NOW, THEREFORE, IT IS HEREBY ORDERED BY THE AFFIRMATIVE VOTE OF NOT FEWER THAN THREE COMMISSIONERS:

8. Having considered the Findings and Recommendations of the Hearing Examiner in this Docket, having reviewed the Exceptions to the Findings and Recommendations of the Hearing Examiner timely filed by Tidewater and the Division of Public Advocate and having entertained oral argument from the parties in connection therewith, the Findings and Recommendations of the Hearing Examiner are APPROVED. Thompson-Schell, LLC is not liable to Tidewater for the tax "gross up" costs with respect to the CAICs paid in connection with the Woodfield Preserve development.

BY ORDER OF THE COMMISSION:

_____

Dallas Winslow, Chairman

_____

Joann Conaway, Commissioner

Harold Gray, Commissioner

Manubhai "Mike" Karia, Commissioner

Kim F. Drexler, Commissioner

ATTEST:

Donna Nickerson, Secretary

EXHIBIT “A”

EXHIBIT A

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Glenn C. Kenton, having been appointed to act as replacement Hearing Examiner in this matter pursuant to a referral by the Executive Director dated March 10, 2021 as provided in the Rules of Practice and Procedure (26 *Del. Admin. C.* §1001-2.5.2), submits to the Delaware Public Service Commission the following Findings and Recommendations of the Hearing Examiner in response to a Formal Complaint filed by Thompson Schell, LLC against Tidewater Utilities, Inc.

Pursuant to 29 *Del. C.* § 8716, a Statutory Notice of Intervention was filed by the Delaware Division of the Public Advocate, Regina A. Iorii, Esquire. Staff of the Public Service Commission did not participate in the proceedings.

Dated: April 8, 2021

Glenn C. Kenton
Hearing Examiner

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I. APPEARANCES

On Behalf of the Complainant, Thompson Schell, LLC ("the Owner"):

By: THOMAS P. MCGONIGLE, ESQ.
Faegre Drinker Biddle & Reath LLP

By: JOSEPH C. SCHOELL, ESQ.
Faegre Drinker Biddle & Reath LLP

On Behalf of the Division of the Public Advocate ("Public Advocate" or "DPA"):

By: REGINA A. IORII, ESQ.
Division of Public Advocate ("DPA")

On Behalf of the Respondent, Tidewater Utilities, Inc., ("Tidewater"):

By: RONALD S. GELLERT, ESQ.
Gellert Scali Busenkill & Brown, LLC

By: ERIC J. WALLACE, ESQ. (Pro Hac Vice)
Greene Hurlocker, PLC

By: BRIAN R. GREENE, ESQ. (Pro Hac Vice)
Greene Hurlocker, PLC

On Behalf of the Delaware Public Commission Staff ("the Staff"):

By: JAMES GEDDES, ESQ.
Delaware Public Service Commission

II. EXECUTIVE SUMMARY

1. Thompson Schell, LLC ("Owner") is a Delaware limited liability company which is in the process of constructing residential homes in Sussex County, Delaware including one project known as Woodfield Preserve. Tidewater Utilities, Inc. ("Tidewater") has a certificate of public convenience and necessity to provide water services for the area, including for Woodfield Preserve.
2. On April 9, 2006, Owner and Tidewater entered into a water services agreement ("WSA") specifying, *inter alia*, the terms and conditions upon which Tidewater was to provide water services to Woodfield Preserve and Owner was to make a contribution-in-aid-of-construction ("CAIC") to support the project.
3. A dispute has arisen between them as to who would bear the cost of any tax "gross up" that might be imposed upon Tidewater for its receipt of any CAICs. At the time of the execution of the Woodfield Preserve WSA, there was no federal tax imposed upon a water utility for the receipt of CAIC funds. However, in 2017 the federal tax law changed and made such contributions taxable to water utilities.
4. The Woodfield Preserve WSA was silent as to who would bear such tax costs, likely because, at that time, federal tax law exempted from taxation any CAICs received by water utilities.
5. At the time of the execution of the Woodfield Preserve WSA, the then-current Minimum Standards provisions governing water services provided that any tax "gross up" would be the responsibility of the utility for which it was given the opportunity to recover the extra tax costs in its rates.
6. Effective April 10, 2006, the Minimum Standards were amended by the Commission to permit – but not require – a utility to add the tax "gross up" to the developer's CAIC thus shifting the tax costs to the developer. At the same time, the Minimum Standards provided that its amended provisions would be effective only prospectively, not retroactively.
7. Shortly after 2017, the federal tax law with respect to a utility's tax liability for CAICs changed making the receipt of CAICs taxable to water utilities. In 2018, in response to the federal tax law change, Tidewater's tariff was amended providing for the tax "gross up" for CAICs received to be paid by the developer. As a result, in 2020 Tidewater sent

to Owner an invoice for the tax "gross up" of the CAICs it had received from Owner for the Woodfield Preserve project. Owner objected and the parties agreed to escrow the disputed funds and submit the issue to the Commission for its determination.

8. Owner argues that the "prospective only" effect of the 2006 Minimum Standards amendments means that the then-current rule that a utility would bear the tax "gross up" costs (which could then be passed on to its customers in its rates) applies and thus the Owner is not responsible for the tax "gross up" costs of the CAIC that was enabled in 2018 by Tidewater's tariff amendment.
9. Tidewater (and the DPA) argue that the specific provisions of the 2006 Woodfield Preserve WSA subject the Owner to future changes in the rules, regulations and tariff provisions affecting the Woodfield Preserve project and thus make Owner responsible for the tax "gross up" cost of the CAICs.
10. I have read carefully the provisions of the 2006 Woodfield Preserve WSA, the rules and regulations surrounding the payment and receipts of CAICs for water developments and the numerous cases cited by the parties to support their respective positions. I find that the Woodfield Preserve WSA is unclear as to the liability of Owner for tariff changes that require or permit a water utility to bill a developer for the tax "gross up" of CAICs. That perhaps is not surprising because, at the time of the Woodfield Preserve WSA, CAICs were not taxable to water utilities.
11. As a result, I find that Delaware law that clearly does not favor giving retroactive effect to contracts, controls. Thus, I find that the then-existing (April 9, 2006) rule that tax "gross ups" for CAICs received are the responsibility of the utility (which can then be added to a utility's rate base). In so finding, I fully recognize that this result is contrary to the current policy of the Commission which permits tax "gross ups" to be shifted to developers. Nevertheless, that was not the policy of the Commission at the time the Woodfield Preserve WSA was entered into by the parties.

III. BACKGROUND

12. Owner is a Delaware is a limited liability company which is in the process of constructing residential homes in Sussex County, Delaware. In 2016, Owner began construction of its new 253 single-family residential development, called Woodfield Preserve. There are multiple phases 1-4 to Owner's development, with homes sold and

some occupied. The site work and infrastructure are targeted for completion and the project is entering into phase 4.

13. Tidewater, having secured a Certificate of Public Convenience and Necessity for the property, in 2006 entered into a water services agreement ("WSA") with Owner for the Woodfield Preserve development.
14. On May 6, 2020, the Owner received a payment invoice from Tidewater in the amount of $ 75,016.93 representing Tidewater's tax liability related to the CAIC Tidewater had received from Owner in connection with the Woodfield Preserve development. The demand for payment included an issuance of "Stop Work Notice" if payment was not tendered within 30 days. Owner disputed Tidewater's invoice and argued that it was not required to reimburse Tidewater for its tax liability with respect to the CAIC.
15. Negotiations between the parties to resolve the dispute were unsuccessful. At that point, the parties agreed that Owner would escrow the invoice amount pending a decision by the Commission as to the question of Owner's liability for Tidewater's CAIC tax liability for the Woodfield Preserve development. (Although not directly in dispute at the current time, the parties understand that the resolution of the issue of Owner's liability for the CAIC tax "gross up" for Woodfield Preserve could also likely affect three (3) other similarly situated developments of Owner for which there are similar WSAs in place from 2006 or before - Marine Farm, Oak Creek and The Preserves at Jefferson Creek.)
16. In connection with the parties' agreement to seek the Commission's decision with respect to the issue of the responsibility of the tax liability related to the CAIC paid to Tidewater by Owner, the parties agreed that Owner would submit a formal complaint to the Commission, Tidewater would respond and thereafter the parties agreed to a two round briefing schedule together with a set of agreed stipulations (the "Revised Stipulations").

IV.THE COMPLAINT

17. On July 10, 2020, Owner filed with the Commission a formal complaint (the "Complaint") against Tidewater seeking an order of relief to prohibit Tidewater from collecting payment from the Owner for Tidewater's federal income tax liability related to the Owner's CIAC under the Woodfield Preserve WSA and the Commission's regulations.

18. According to Owner, from April 2006 until 2017, the federal tax code imposed no income tax upon a utility's acceptance of CIAC unless the CIAC was recovered from customers in utility rates. In 2017, the federal tax code was amended in the Tax Cuts and Jobs Act of 2017 to eliminate the tax exemption for CAICs received by water utilities.[1]
19. As alleged in the Complaint, prior to April 10, 2006 Commission regulations provided that any federal or state income taxes associated with a landowner's transfer of a CIAC to a utility would be paid by the utility, treated as capital to be recovered by the utility in its rates.[2]
20. According to the Complaint, in 2006 the Commission amended Regulation Docket 15 with respect to CAICs paid by landowner to water utilities resulting in PSC Order No. 6873 ("Order 6873") effective April 10, 2006. Among other changes to the calculation of a CAIC, Order 6873 provided that if a utility's acceptance of a CIAC would cause the utility to incur income tax liabilities, the utility would be "permitted" – but not required – to "gross up" the amount of the required CIAC to cover the liability.[3]
21. Further, according to Owner's Complaint, Order 6873, effective April 10, 2006, contained a provision that its provisions would apply only prospectively which, according to Owner's Complaint, was included "presumably… to assure landowners, developers and financial institutions Docket 15 would not undermine developments with existing water service agreements."[4] Quoting from the regulation:

> Shall…apply prospectively and therefore shall not affect or apply to circumstances where the water utility has already entered into a water service agreement with the contractor, builder, developer, municipality, homeowner, or other person, regarding the construction of water facilities.[5]

22. According to the Complaint, the April 10, 2006 effective date of Order 6873 is important because the effective date of the Woodfield Preserve WSA is April 9, 2006 and thus not subject to the prospective provisions of Order 6873 that permits – but does not require – a water utility to "gross up" a CAIC for its tax impact.

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[1] Pub. L. 115-97, 131 Stat. 2054, § 13312(a) (Dec. 22, 2017).
[2] PSC Order No. 4465 dated April 8, 1997 ("Order 4465") 29 *Del. Admin. C.* § 2001-3.8.7.
[3] 26 *Del. Admin. C.* § 2001-3.8.6.
[4] Complaint at ¶ 5.
[5] 26 *Del. Admin. C.* § 2001-3.8.9.1.2.

23. According to the Complaint, Tidewater's attempt to collect from it the re-imposed, in 2017, tax liability of water utilities for CAIC payments received from landowners "is fundamentally inconsistent with Commission regulations, and effectively would grant Tidewater retroactive rights to apply Order No. 6873, even though the Order itself makes abundantly clear that any ability to 'gross up' CIAC contributions would apply prospectively only."[6]

V. TIDEWATER'S ANSWER

24. In its Answer, Tidewater admits many of the factual recitations of the Owner in its Complaint, but "denies the allegation that the WSA "does not include any provision, requirement, obligation or reference to the [Complainant] being required to pay Tidewater's tax liabilities."[7] Paragraph 16(c) of the WSA provides that Complainant and Tidewater "shall be bound by present and future rules and regulations of the PSC…and the tariff, and rules and regulations of Tidewater and agree to abide by the same." Paragraph 16(c) of the WSA further provides that:

> Should new rules and regulations be adopted or standards, requirements, permits or orders be issued by the PSC, DNREC, the Division of Public Health and/or by any other governmental agency, by reason of which it becomes necessary to make changes or additions to the contemplated or constructed water distribution system installation or in any of the provisions of this Agreement relating to same, then and in such case, this Agreement shall be deemed to be amended or supplemented to require compliance therewith, and any increased costs necessary to comply with the same in respect to the subject water distribution system shall thereupon also be promptly paid and advanced by Owner pursuant to paragraphs 4 and 6 and by Tidewater pursuant to paragraphs 5, 8 and 9 hereinabove, and Owner shall observe any additional rules, regulations, standards or requirements imposed on the use or conduct of such water distribution system.[8]

25. Tidewater then cites its tariff amendment of May 8, 2018 that provides, in part, "All CIAC…received by the Company…is subject to an income tax liability gross-up

[6] Complaint at ¶ 8.
[7] Answer at ¶ 11.
[8] Revised Stipulations Exhibit F ¶ 16(c).

payment by the contributor based on the value of the CIAC."[9] Accordingly, as alleged by Tidewater, as Owner agreed to be bound by "present and future regulations of the PSC … and the tariff, and rules and regulations of Tidewater and agree to abide by same,"[10] Owner is liable for the tax "gross up" of the CAIC received by Tidewater for the Woodfield Preserve development as provided it its 2018 tariff revision.

VI. BRIEFS OF THE PARTIES

A. Owner's Opening Brief.

26. In its Opening Brief, Owner recites the history of Regulation Docket 15 beginning in 1988 when the Commission adopted PSC Order No. 2928 ("Order 2928") which made a distinction between Advances and CAICs with respect to water system extensions and improvements, but provided that if a water utility accepted a CAIC the utility would be required to pay the tax associated with the CAIC upon which a utility would then have the opportunity to earn a return in its rate base.[11]

27. On April 8, 1997, according to Owner, the Commission again amended Regulation Docket 15 in Order 4465, in part due to the federal tax law change, but kept in place the previous provisions of Order 2928 providing that "if taxes associated with CIAC were due from the utility, then the taxes paid could be included in the utility's rate base and subject to a return on investment."[12]

28. According to Owner, the Commission again amended Regulation Docket 15 via Order 6873, effective April 10, 2006 (the "2006 Amendments"), in which a water utility was "permitted but not required" to "gross up" a CAIC for the tax effect:

> A CIAC will consist of an amount equal to the entire estimated cost, including the utility's standard overhead costs, of constructing the Facilities Extension. If any portion of property contributed by the contractor, builder, developer, municipality, homeowner, or other project sponsor is deemed taxable income to the utility, the utility shall be permitted to gross up the amount of the CIAC to include such tax liability.[13] (emphasis added)

29. According to Owner, the "gross up" provision of Order 6873 was meant to be "prospective

[9] Answer at ¶ 11.
[10] Woodfield WSA, Section 16(c) at 11, Revised Stipulation F.
[11] Order No 2928 ¶ 16.
[12] Owner Op. Br. at 5.
[13] *Op. cit*. 26 *Del. Admin. C.* § 2001-3.8.6.

only" as provided in Section 3.8.9.1.2 of the Minimum Standards[14] and because the Woodfield Preserve WSA was effective on April 9, 2006, the revised language permitting tax "gross ups" does not apply to the Woodfield Preserve development (nor to any of the other developments at issue).

30. With respect to Tidewater's argument that its tariff change contained in Order 9219 (adopted May 8, 2018) applies to the 2006 WSAs and permits Tidewater to "gross up" the CAIC for its tax effect, in its Opening Brief Owner provides several arguments to the contrary and cites several supporting case decisions (each of which I have reviewed):

    (i) None of the WSAs have any provisions to require Owner to reimburse Tidewater for the "gross up" tax costs for any CAIC paid.

    (ii) Delaware law does not favor retroactive changes to executed contracts.

    (iii) the language in the 2006 Amendments as contained in Order 6873 specifically provides that the 2006 Amendments with respect to the CAIC changes are to be effective only prospectively.

    (iv) Order 6873 only permits, but does not require, water utilities to "gross up" CAIC receipts for the tax effect and leaves in place the previous rule that the tax "gross up," if any, with respect to CAIC payments received by a utility may be included in its rate base allowing it a return on the investment.

    (v) The language contained in the various WSAs (Section 16(c) of the Woodfield Preserve WSA) binding Owner to the "future rules and regulations of the PSC, DNREC, the Division of Public Health and the tariff, rules and regulations of Tidewater…" does not bind Owner to future tariff changes - only "future rules and regulations of the PSC, DNREC and the Division of Public Health." (emphasis added)

    (vi) The Woodfield Preserve WSA is a pre-Order 6873 agreement and thus the provisions of Order 6873 left in place the then-current rule that these costs "may be added to rate base, at which time the utility will have an opportunity to earn a fair return on this amount."[15]

[14] Owner's Op. Brief, ¶ 10.
[15] *Op. cit*. 26 *Del. Admin. C.* § 2001-3.8.7

B. Tidewater's Initial Brief

31. In its Initial Brief, Tidewater reviews the history of the federal tax law changes as they affect CAICs received by a water utility and the various changes to Regulation Docket 15, some of which were in reaction to the federal tax law changes.

32. Tidewater provides several arguments in its Initial Brief to rebut the arguments of Owner and cites several supporting case decisions (each of which I have reviewed):

(i) The provisions of the various WSAs are clear on their face, not ambiguous and require Owner to reimburse Tidewater for the tax effect of the CAICs. Tidewater also cites the preamble language contained in the Woodfield Preserve WSA to support its position as to the interpretation of the WSA that Owner is responsible for the tax effect to Tidewater of the CAICs. The preamble provides:

> Should new rules and regulations be adopted or standards, requirements, permits or orders be issued by the PSC… and/or by any other governmental agency, by reason of which it becomes necessary to make changes or additions to the contemplated or constructed water distribution system installation or in any of the provisions of this Agreement relating to the same, then and in such case, this Agreement shall be deemed to be amended or supplemented to require compliance therewith, and any increased costs necessary to comply with the same in respect to the subject water distribution system shall thereupon also be promptly paid and advanced by Owner pursuant to paragraphs 4 and 6 and by Tidewater pursuant to paragraphs 5, 8 and 9 hereinabove, and Owner shall observe any additional rules, regulations, standards or requirements imposed on the use or conduct of such water distribution system.[16]

(ii) According to Tidewater, "To the extent that the prospective language in the Commission's 2006 regulations conflicts with the WSA language subjecting the WSA to changes in both Commission regulations and the

[16] Revised Stipulations, Exhibit F ¶ 16)c); see also Exhibit J ¶ 10, Exhibit K ¶ 9, Exhibit L ¶ 8-9.

Tidewater tariff, the express language in the WSA should control and permit Tidewater to gross up CIAC for income taxes."[17]

(iii) Public policy supports requiring developers rather than ratepayers paying for the increased tax costs of CAICs.

C. DPA Opening Brief

33. In its Opening Brief, DPA also reviews the history of the federal tax law changes as they affect CAICs received by a water utility and the various changes to Regulation Docket 15, some of which were in reaction to the federal tax law changes.

34. DPA provides several arguments in its Opening Brief to rebut the arguments of Owner and cites several supporting case decisions (each of which I have reviewed):

(i) The Woodfield Preserve WSA and the WSA for The Preserves at Jefferson Creek were not "entered into" prior to April 10, 2006, as the corporate acknowledgement of Owner for the Woodfield Preserves WSA is dated April 10, 2006 while the corporate acknowledgement of Tidewater is dated April 26, 2006, and Tidewater's corporate acknowledgement for the WSA for The Preserves at Jefferson Creek is dated April 28, 2006.

(ii) As alleged by Tidewater, each of the WSAs contains language in Paragraph 16(c) that provides the Complainant and Tidewater "shall be bound by present and future rules and regulations of the PSC…and the tariff, and rules and regulations of Tidewater and agree to abide by the same" and thus Owner is bound by Tidewater's 2018 tariff change.[18]

(iii) DPA also cites the preamble language in the various WSAs that is similar to the Woodfield Preserve WSA that "Tidewater is willing to furnish public utility water service to the Development pursuant to its rates, rules, and regulations as they presently exist and as from time to time may be amended and filed with the … Commission"[19] as support for its position.

[17] Tidewater Op. Br. at 16.
[18] Revised Stipulations F ¶ 16(c).
[19] Revised Stipulations F, p. 1.

(iv) As Delaware has adopted the "filed rate" doctrine, every developer is responsible for paying Tidewater's tax on its CAIC "regardless of whether a provision stating this liability was included in the contract." In fact, DPA points out that the CAICs in question were contributed to Tidewater on July 31, 2018, August 15, 2018, October 28, 2019, and March 25, 2020, respectively, all after the May 8, 2018 effective date of Order 9219 that provided for Tidewater to collect the tax "gross ups" from developers.

(v) With respect to Owner's reference to Staff's 2005 brief in urging the adoption of the "prospective only" language of revised regulations of Regulation Docket 15 in Order 6873, DPA asserts that neither Staff nor DPA were parties to the various WSAs, therefore those provisions are not binding on Staff nor DPA.

D. Owner Answering Brief

35. In its Answering Brief, Owner responds to the arguments of both Tidewater and DPA in their initial briefs as follows:

(i) Referencing the much-argued-about provisions of Section 16(c) of the Woodfield Preserve WSA, Owner argues that "there has been no order, regulation or change of law that renders it …necessary to make changes or additions to the contemplated or constructed water distribution system installation. Owner argues that there is no difference in the system or the standards the system is required to meet. "The only change is the different tax treatment imposed by the federal government on CIAC received by Tidewater."[20]

(ii) Referencing again the provisions of Section 16(c) of the Woodfield Preserve WSA, Owner argues that the language only provides that Owner agrees to be bound by "bound by present and future rules and regulations of the PSC, DNREC, the Division of Public Health…" and not the language after the word "and the tariff, rules and regulations of Tidewater."[21]

[20] Owner Ans. Br. at 4.
[21] *Id.*

(iii) With respect to the arguments of both Tidewater and DPA citing the language in the recitals to the various WSAs as giving additional support to their arguments, Owner first argues that recitals in a contract "do not themselves fix obligations of the parties…"[22], but more substantively, Owner argues that the recitals language has nothing to do with the current dispute.

(iv) Owner reiterates its early argument that the "prospective only" language of Order 6873 provides that the Owner would not, and should not, be bound by future changes with respect to the tax effects of a utility's receipt of CAIC contributions.

(v) Next, Owner argues that if it were the intent of the 2018 tariff changes as provided in Order 9219 to be effective retroactively, Owner should have received "reasonable notice" of that intent and points out that nothing in any of the public notices with respect to Order 9219 made mention of that intent.

(vi) With respect to DPA's argument that the WSAs for Woodfield Preserve and The Preserves at Jefferson Creek were not effective prior to the April 10, 2006 effective date of Order 6873 because the acknowledgement pages were not a part of the core agreement, Owner argues that Delaware law provides that contracts are effective on the dates which the parties agree, even prior to the execution of the agreement "in the absence express language showing a contrary intention."[23] Owner also argues that, even if Woodfield WSA is found to be effective after the April 10, 2006 effective date of Order 6873, nevertheless the language of Section 16(c) does not make it necessary to amend the WSA as Order 6873 only permits – but does not require - Tidewater to "gross up" the CAIC.

(vii) Finally, Owner points out that the issue before the Commission at this time is not whether Tidewater can or will be able to add the tax costs to its rate base. Owner argues that is a matter for another proceeding.

[22] *Id.* at 6.
[23] *Id.* at 9.

E. Tidewater Answering Brief

36. In its Answering Brief, Tidewater responds to the arguments of Owner in its Opening Brief as follows:

(i) Owner agreed to the "change-in-law" provisions in the WSAs which amended the terms of the WSAs when the Commission approved Tidewater's un-opposed tariff updates, requiring developers to make gross-up payments for CIAC income tax liability.

(ii) Absent express language in the WSAs allocating responsibility for income taxes imposed on CIAC, the broad change-in-law provisions control.

(iii) Owner's and Tidewater's intent, as expressed in the plain language of the WSAs, was for the terms of the WSAs to be amended by changes in Tidewater's tariff and Commission orders.

(iv) Owner misinterprets the first sentence of Section 16(c) of the Woodfield Preserve WSA in arguing that the language after the word "and" is not subject to the obligation of Owner to be bound by the "present and future" tariff changes, as well.

(v) Subsequent rephrasing of the Carillion WSA change-in-law language in a 2017 WSA to clarify the issue in dispute is inapplicable extrinsic evidence.

(vi) Additional language in the recitals reinforces that Owner's interpretation of the Woodfield Preserve WSA Section 16(c) change-in-law provision is erroneous and counter to the parties' intent.

(vii) Tidewater's requirement that Owner pay for CIAC-related income tax liability it caused does not violate Order No. 6873 because of the "express language" in the WSAs that provided for Owner to be bound by Tidewater's future tariff changes.

(viii) Complying with the tariff requirements in effect at the time Owner contributed CIAC to Tidewater is not "retroactive ratemaking" as Tidewater is not trying to impose a rate surcharge on its customers.

(ix) Tidewater agrees with Owner's interpretation that the Woodfield Preserve WSA and the Preserves at Jefferson Creek WSA were entered into prior to April 10, 2006.

F. DPA Reply Brief

37. In its Reply Brief, DPA reiterates its arguments in its Initial Brief and responds to two additional arguments of Owner as follows:

(i) DPA states that Staff's brief in supporting Order 6873 explaining its "prospective only" language is irrelevant because the Woodfield Preserve and The Preserves at Jefferson Creek were entered into after the effective date of Order 6873 as the acknowledgement pages show a later date than April 10, 2006.

(ii) Owner's argument that subjects it to the later-enacted tariff provision is "retroactive rate making" is not accurate because requiring Owner to pay for the tax "gross up" does not affect customer rates at all.

VII. DISCUSSION

A. Introduction.

38. The fundament issue at stake in this matter is quite straightforward: "Is the Owner required to reimburse Tidewater for the additional tax cost incurred by Tidewater in connection with the Owner paying to Tidewater the CAIC with respect to several developments either under construction or planned in Sussex County, Delaware or is Tidewater responsible for the tax costs and thus allowed to pass these costs on to it ratepayers?"

39. However, the issue has become anything but straightforward because of various federal tax law changes with respect to the tax consequences to utilities for receiving CAIC payments and the Commission's periodic response to these changes.

40. As stated in Sections 18, 19 and 20 above and as recited in each of the parties' briefs in this docket, prior to the Tax Reform Act of 1986 CIAC payments to utilities were generally exempt from income tax. The Tax Reform Act of 1986 modified that and made CIAC to utilities subject to income tax on the utility.[24] In 1996, Congress enacted the Small Business Job Protection Act, which exempted water and wastewater

[24] Pub. L. 99-514, 100 Stat. 2085, enacted Oct. 22, 1986.

utilities from income tax on CIAC.[25] That status continued for twenty (20) years until 2017 when water and wastewater utilities were again subject to federal income tax on any CAIC received. In summary, for twenty years following enactment of the Small Business Job Protection Act, CIACs received by water and wastewater utilities were exempt from federal income tax. That changed in December 2017 when Congress reinstated income tax to water and wastewater utilities in connection with CAICs received by them.[26]

41. In response to the various tax law changes with respect to CAIC contributions received by water and wastewater utilities, the Commission, not surprisingly, regularly changed its rules and regulations with respect thereto. In 1988, the Commission adopted PSC Order No. 2928 making a distinction between advances and CAICs and making any tax consequences for the receipt of CAICs the responsibility of the utility which could then pass along to its ratepayers. Following the 1996 federal tax law change exempting water and wastewater utilities from tax upon a CAIC, the Commission again, in PSC Order No. 4465, made changes to its regulations but kept in place its previous rule that, should a CAIC become taxable to a water utility, it could still pass these costs along to its ratepayers.

42. In 2003, the Commission re-opened Regulation Docket 15 out of concern that the then-current CAIC rules were insufficient to protect ratepayers from the costs of a water utility's expansion. These efforts culminated in 2005 with a lengthy Hearing Examiner's Report by William O'Brien and a subsequent order by the Commission (PSC Order No. 6873) to tighten up the CAIC rules. As there were no tax consequences at that time for a water utility receiving a CAIC, Order 6873 left in place the previous rule that if there were any tax consequences, they would be paid by the utility for which it would then be allowed to be included in its rate base to earn a return on such amount,[27] but that any future tax consequences to water utilities were permitted (but not required) to be "grossed up" by the utility and thus borne by the developer.[28]

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[25] Pub. L. 104-188, 110 Stat. 1755, enacted Aug. 20, 1996.
[26]Tax Cuts and Jobs Act of 2017. Pub. L. 115-97, 131 Stat. 2054, § 13312(a), enacted Dec. 22, 2017.
[27] *Op. cit.* 26 *Del. Admin. C.* § 2001-3.8.*7.*
[28] *Op. cit.* 26 *Del. Admin. C.* § 2001-3.8.*6.*

43. It is that Order No. 6873 that lies at the heart of the current dispute, because in connection with the enactment of the final order, to make sure the new rules and regulations would not be applied retroactively, the parties agreed to the insertion of a provision that Order 6873 would be prospective only and not applicable to any WSA entered into prior to the April 10, 2006 effective date of Order 6873.[29]
44. Not surprisingly, the Owner and Tidewater agreed that two (2) of the WSAs in question (the Woodfield Preserve WSA and the WSA for The Preserves at Jefferson Creek) were to be effective just prior to the April 10, 2006 effective date of Order 6873 – the Woodfield Preserve WSA on April 9, 2006 and The Preserves at Jefferson Creek on April 7, 2006. (The remaining WSAs for Marine Farm and Oak Creek were entered into earlier – Marine Farm on February 11, 2004 and Oak Creek on May 7, 2004.) (DPA disagrees that the effect dates of the Woodfield Preserve and The Preserves at Jefferson Creek were prior to April 10, 2006.)
45. The Owner's position is that the WSAs in question are "grandfathered" because of the language contained in the Section 3.8.9.1.2 of the Commission's Minimum Standards Governing Service Provided by Public Water Companies as enunciated in the 2006 Amendments to Regulation Docket 15 which made the effectiveness of the 2006 Amendments prospective only. The 2006 Amendments as contained in Order 6873 for the first time provided that a water utility is permitted (but not required) to "gross up" CAIC payments received for the tax impact[30] as opposed to the prior rule (which stayed in place) making the water utility liable for these costs but provided that these costs "may be added to rate base, at which time the utility will have an opportunity to earn a fair return on this amount."[31]
46. DPA and Tidewater argue that the various WSAs include language that subjects the Owner to future tariff changes of a water utility that would make Owner subject to Tidewater's May 8, 2018 tariff amendments as contained in Order 9219, including the new language that requires Tidewater to "gross up" its additional tax costs from a CAIC thus making developers liable for the additional tax costs.

[29] *Op. cit.* 26 *Del. Admin. C.* § 2001-3.8.9.1.2.
[30] *Op. cit*. 26 *Del. Admin. C.* § 2001-3.8.6.
[31] *Op. cit*. 26 *Del. Admin. C.* § 2001-3.8.7.

47. Each of the parties has advanced several (indeed numerous) arguments to support its respective positions – that either the Owner pays the additional tax costs in connection with the CAIC for the developments in dispute (Tidewater and DPA's position) or the tax costs are the responsible of Tidewater - potentially to be passed on to Tidewater's customers (the Owner's position).

B. Are the WSAs "ambiguous?"

48. In considering the parties' various arguments over six (6) briefs, the first issue is whether the four (4) WSAs in question clearly require the Owner to pay the tax "gross up" costs of Tidewater (Tidewater and DPA's position) or whether it is not clear? If the language is clear (as alleged by Tidewater and DPA), then Owner is liable for the tax "gross up" of the CAICs and further inquiry is not necessary.[32]

49. Tidewater cites several sections of the WSAs at issue that it says clearly require the Owner to pay for any future costs attributable to changes in the rules, regulations and tariff affecting Tidewater. Tidewater cites numerous cases to support the proposition that if the provisions of the agreement are clear and unambiguous, (which it argues is the case here), "the courts give effect to 'the plain meaning of the contract's terms and provisions.'"[33] Further, "A contract is ambiguous when courts may reasonably ascribe multiple and different interpretations to a contract." "Importantly, a 'contract is not rendered ambiguous simply because the parties do not agree upon its proper construction.'"[34] As cited by Tidewater, "Contract terms themselves will be controlling when they establish the parties' common meaning so that a reasonable person in the position of either party would have no expectations inconsistent with the contract language."[35]

50. Owner not only disputes Tidewater's assertions that the provisions of the various WSAs clearly require it to pay for future increased costs due to Tidewater's tariff changes but argues forcefully that the provisions of the various WSAs together with the "prospective only" language of Order 6873 do not so provide.

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[32] *Estate of Osborn v. Kemp*, 991 A.2d 1153, 1159-60 (Del. 2010) (quoting *Paxson Commc'ns v. NBC Universal,* 2005 Del. Ch. LEXIS 56, 2005 WL 1038997, at *5 (Del. Ch. Apr. 29, 2005).
[33] *Estate of Osborn v. Kemp*, 99*1* A.2d 1153, 1159-60 (Del. 2010) (quoting *Paxson Commc'ns v. NBC Universal,* 2005 Del. Ch. LEXIS 56, 2005 WL 1038997, at *5 (Del. Ch. Apr. 29, 2005).
[34] Tidewater Op. Br. at 10.
[35] *Eagle Indus., Inc.* v. DeVilbiss Health Care, Inc., 702 A.2d 1228, 1232 (Del. 1997).

51. I agree with Tidewater that if the intent of the parties is clear from the four corners of the agreement(s), further inquiry is not needed. However, having reviewed the parties' various briefs together with the various documents and regulations at issue, I believe the intent of the various WSAs on this issue is ambiguous. The language is susceptible to more than one reasonable interpretation. In the test of *Eagle Industries*, "a reasonable person in the position of either party would have no expectations inconsistent with the contract language," cited by Tidewater, I do not believe is met. I believe that a reasonable person of either party would, in fact, have different expectations. As a result, I am guided by the court's language in *Concord Steel, Inc. vs. Wilmington Steel Processing Co., Inc*.[36] as follows:

> The court's ultimate goal in contract interpretation is to determine the parties' shared intent…Under the parole evidence rule, where the language of a written integration is susceptible to more than one reasonable interpretation, the court will consider proffered admissible evidence bearing upon the objective circumstances relating to the background of the contract. Such extrinsic evidence may include overt statements and acts of the parties, the business context, prior dealings between the parties, and business custom and usage in the industry.

It is with this guidance that I consider the parties' various arguments in support of their respective position(s).

C. Effective Dates of the WSAs

52. I think the best way to sort through the numerous arguments is to begin by dealing with – and eliminating – an initial ancillary argument of DPA that I do not believe is determinative of the issue at hand in any case. Then I will turn to the heart of the arguments.

53. The argument proffered by DPA that at least two of the WSAs (for Woodfield Preserve and The Preserves of Jefferson Creek) were not effective until after the key date of April 10, 2006, the effective date of the 2006 Amendments contained in Order 6873. While the stated dates of the Woodfield Preserve WSA is April 9, 2006 and The Preserves at Jefferson Creek WSA is April 7, 2006, DPA points out that the

[36] 2008 WL 902406 at 2 (Del. Ch. Apr. 3, 2008).

acknowledged date of Owner's execution of the Woodfield Preserve WSA is April 10, 2006 while Tidewater's is April 28, 2006.[37] With respect to the WSA for The Preserves at Jefferson Creek, DPA points out that while the handwritten date is April 7, 2006, the Tidewater corporate acknowledgement occurred later - on April 28, 2006.[38] According to DPA, as a result of the corporate acknowledgements of both the Woodfield Preserve WSA and The Preserves at Jefferson Creek both became effective after the key date of April 10, 2006, the date of the effectiveness of Order 6873.

54. DPA cites the case of *Sweetman vs. Stresscon Industries, Inc*. to support its position, quoting as follows:

> Assigning a date to a contract which antedates the execution, in the absence of express language showing a contrary intention, makes the contract effective on that date which the contract bears. Here, a later date does appear following the signature. The presence of two different dates creates an ambiguity which opens the matter to evidentiary proof that the date appearing at the beginning of the agreement should not control the inception of rights and liability thereunder.[39]

55. As evidentiary proof that the date appearing at the beginning of the WSAs should not control, DPA focuses on the fact that the corporate acknowledgements were not integrated into the body of the WSAs, but rather on a separate page.
56. In opposition, the Owner argues that despite the signings being acknowledge after April 10, 2006, it is the stated effective date on the WSAs that is controlling and cites several authorities to support its position (including *Sweetman*.)[40]
57. Owner also argues forcefully that, regardless of the effective dates of the various WSAs, Order No. 6873 only permits – but does not require - Tidewater to "gross up" the CAIC for the tax effect, a key distinction in support of its argument.
58. Interestingly, Tidewater sides with the Owner with respect to this issue, arguing it is the stated effective date of the two WSAs that controls, and has cited authority, including *Sweetman* for its position in support of the Owner. As stated by Tidewater:

[37] Revised Stipulations, Exhibit F p. 15. DPA Op. Br. at 8.
[38] Revised Stipulations, Exhibit L p. 12. DPA Op. Br. at 13.
[39] *Sweetman v. Stresscon Industries, Inc.*, 389 A.2d 1319, 1322 (Del. Super. 1978).
[40] Owner's Ans. Brief at 9, 10.

> However, the *Sweetman* holding does not support DPA's argument in this case regarding the difference between the effective dates in the WSAs and the dates of the Corporate Acknowledgements. Unlike Sweetman, the WSAs in this case only include one effective date, which is specified at the beginning of the agreements. The Corporate Acknowledgement simply acknowledged that the parties were authorized to enter into the WSAs. There is no conflicting or later date accompanying the signatures in the WSAs, as there was in Sweetman.[41]

59. Of importance, Tidewater also points out that there are two remaining WSAs (Marine Farm and Oak Creek) at issue in this matter that were clearly effective well before the April 10, 2006 date (actually, in 2004), so even if DPA's position with respect to the Woodfield Preserves and The Preserves of Jefferson Creek WSAs is accepted, there are still two remaining WSAs that would be at issue.
60. Having reviewed *Sweetman*, I agree with the Owner and Tidewater that it is the stated effective date of the WSAs, absent clear evidence to the contrary, that controls the various WSAs. DPA has offered only an argument that the acknowledgements of the two (2) WSAs in question are on separate pages from the core agreements and a thus not part of the core agreements. I do not believe this is sufficient evidence to deviate from the basic rule that parties are free to agree to an effective date for contracts, even effective dates prior to their signing. That occurs all the time. I believe the clear intent of the parties was to make the effective date of the Woodfield Preserves WSA and The Preserves at Jefferson Creek WSA effective prior to the April 10, 2006 effective date of the 2006 Amendments.
61. So, I will eliminate DPA's first argument that the Woodfield Preserve WSA and The Preserves at Jefferson Creek WSA are effective after the April 10, 2006 effective date of the 2006 Amendments. For the purposes of my Findings and Recommendations, I determine that all the WSAs were entered into prior to the April 10, 2006 effective date of the 2006 Amendments. (I also note that the Owner argues that its position would not change regardless of the effect date of the various WSAs.)

D. Owner's Argument Summary

[41] Tidewater Ans. Br. at 16.

62. The heart of the Owner's argument is that the four WSAs in question are not subject to future tariff changes - in particular, the Tidewater 2018 tariff change contained in Order 9219. Owner's basic argument has essentially the following key points:

(i) None of the WSAs have any provisions to require Owner to reimburse Tidewater for the "gross up" tax costs of any CAIC paid.

(ii) Delaware law does not favor retroactive changes to executed contracts.

(iii) The language in the 2006 Amendments as contained in Order 6873 specifically provides that the 2006 Amendments with respect to the CAIC changes are to be effective only prospectively.

(iv) Order 6873 only permits, but does not require, water utilities to "gross up" CAIC receipts for the tax effect and leaves in place the previous rule that any CAIC payments received by a utility may be included in its rate base allowing it a return on the investment.

(v) The language contained in the various WSAs (Section 16(c) of the Woodfield Preserve WSA) binding Owner to the "future rules and regulations of the PSC, DNREC, the Division of Public Health and the tariff, rules and regulations of Tidewater…" does not bind Owner to future tariff changes - only "future rules and regulations of the PSC, DNREC and the Division of Public Health."

(vi) In any case, Owner argues that the further language in Section 16(c) controls the construction of the WSA:

> Should new rules or regulations be adopted or standards, requirements, permits or orders be issued by the PSC, DNREC, the Division of Public Health and/or any other governmental agency, by reason of which it becomes necessary to make changes or additions to the contemplated or constructed Water Distribution System installation or Production Facilities or in the provisions of this Agreement related to same, then and in such case, this Agreement shall be deemed to be amended or supplemented to require compliance therewith, and any increased costs necessary to comply with the same in respect to the subject water system shall

> thereupon also be promptly paid and advanced by Owner pursuant to paragraph 4 and by Tidewater pursuant to paragraphs 7, 8 and 9 hereinabove, and Owner shall observe any additional rules, regulations, standards or requirements imposed on the use or conduct of such Water Distribution System or Production Facilities.[42]

Owner argues that since the tariff changes in Order 9217 are not "changes or additions to the contemplated or constructed Water Distribution System installation or Production facilities" and since the 2006 Amendments as contained in Order 6873 only permit – but do not require - Tidewater to "gross up" a CAIC received for the tax effect, such tariff changes are not "necessary" and thus do not require that the various WSAs be amended to require compliance with the later tariff changes.

E. Discussion of Owner's Arguments and Responses

63. With respect to Owner's first argument that none of the WSAs have any provision requiring Owner to pay and tax "gross" up for CAICs paid, I agree. That is clear. Owner argues that both the 2006 Amendments to Docket 15 and the WSA's themselves could have specifically included a provision/requirement that future tax law changes would be the responsibility of the Owner. But they did not. Owner cites the history of consideration of the effect of tax law changes and its effect on a CAIC to demonstrate that the issue was not a novel issue to Tidewater nor to the Commission (citing two cases in the early 1990s involving *Liborio II, L.P. vs. Artesian Water Co.*[43] discussing the issue) and argues that the omission of any language in the 2006 Amendments is 2006 is telling.

64. Owner further cites later changes to Tidewater's form WSA agreements in which Tidewater specifically makes the agreements subject to Tidewater's "approved tariff, as the same may be amended from time to time" as evidence that the language in the WSAs at issue do not include such language lends support for its arguments that future

[42] Revised Stipulations, Exhibit F ¶ 16(c).

[43] 1991 WL 496991 (Del. P.S.C. Oct. 1, 1991), aff'd, 1993 WL 189530 (Del. Super. Ct. May 17, 1993) and 593 A.2d 571 (Del. Super. Ct. 1990).

tax and tariff changes were not meant to be included in the WSAs when they could have been so included.[44]

65. I agree with the Owner that all these omissions lend support to its basic arguments. But I do not find that they are in themselves determinative. As argued by Tidewater, the WSAs also could have provided that any future tax "gross ups" would be paid by the water utility, but they did not.
66. Owner's next argument is that Delaware law does not favor retroactive changes to executed contracts[45]. According to Owner, "This is particularly so when retroactive application affects the substantive rights of a party."[46]
67. Tidewater and DPA counter by citing language in the various WSAs that they believe override this presumption.
68. Having reviewed the cited cases, I agree with Owner that Delaware law does not favor the retroactive effect of contracts. As stated in *Miller*, "[t]he courts have evolved a strict rule of construction against a retrospective operation," … "[i]t is axiomatic that Courts do not favor retroactive legislation."[47] As stated in *Christopher*, "In the absence of clear language to the contrary, a statute will not be construed as destroying rights existing at the time of enactment."[48]
69. Thus, in my view solid arguments and/or evidence to the contrary by Tidewater and DPA are needed to overcome the presumption against the retroactive effect of contract provisions.
70. As an ancillary argument, Owner argues that making it subject to the provision of future tariff changes is "retroactive ratemaking" and contrary to Delaware law.[49] However, I agree with the position of both Tidewater and DPA that subjecting an Owner to additional costs has nothing to do with ratemaking. It does not directly affect a customer's rates. The Owner paying the extra tax costs itself has zero impact on a utility customer's rates. Indeed, this is the heart of the respective policy arguments of

[44] Carrillion Woods WSA, Section 17(C), attached to Owner's Op. Br. at Exhibit B.
[45] *Miller v. Ellis,* 122 A.2d 314, 316 (Del. Super. Ct. 1956) ("Miller").
[46] *State ex rel. Christopher v. Planet Ins. Co.,* 321 A.2d 128, 134 (Del. Super. Ct. 1974) ("*Christopher*").
[47] *Op. cit. Miller* at 2.
[48] *Op. cit. Christophe*r at 6.
[49] *Public Serv. Comm'n v. Diamond State Tel. Co.*, 468 A.2d 1285, 1299 (Del. 1983); *Chesapeake Utilities Corp. v. Padmore,* 2011 WL 2420681, at *9-*10 (Del. Super. Ct. June 13, 2011).

Tidewater and DPA – that an Owner paying for the extra tax costs of a CAIC saves a utility's customers from potential additional rate costs, and a key rationale for the enactments of the 2006 Amendments to Regulation Docket 15. I conclude that giving effect to the tariff changes at issue is not retroactive making as prohibited by the Commission's rules and regulations.

71. DPA also argues that the "filed rate doctrine" applies to this matter and that the "rights defined by a tariff cannot be varied by a utility's tort or contract."[50] DPA points out that the CAIC payments at issue were all paid in 2018 after the enactment of the Tidewater tariff change in 2017. I have read *Brown* and related cases carefully. First, *Brown* dealt with issues of the waiver of tort liability that the Court says cannot be waived by a contract. This is not a matter of tort liability. But more to the point, I can find nothing in the law regarding the "filed rate doctrine" that says it can override retroactively a contract already agreed to. While the CAIC payments were made after Tidewater's 2017 tariff change, the payments were made pursuant to the 2006 WSA. And thus, I believe that the principles of *Miller* apply that Delaware law does not favor giving retroactive effect to existing contracts.

72. Owner's next argument that the 2006 Amendments contained in Order 6873 contain a section making their provisions prospective only is clear. Section 3.8.9.1.2 of the Minimum Standards so provides:

> Shall… apply prospectively and therefore shall not affect or apply to circumstances where the water utility has already entered into a water service agreement with the contractor, builder, developer, municipality, homeowner, or other person, regarding the construction of water facilities.[51]

73. Owner also cites language in Staff's 2005 brief in support of the 2006 Amendments that lends support to the intent of the parties that the revised regulations are to be effective only prospectively:

> [c]ertain parties raised concerns about the possible retroactive application of the new regulations. Even though DPA and Staff thought the issue was not germane, because the law does not generally permit the

[50] *Brown v. United Water Delaware, Inc*., 3 A.2d 253, 255 (Del. 2010).
[51] *Op. cit*. 26 *Del. Admin. C.* § 2001-3.8.9.1.2

> retroactive application of regulations, they nevertheless agreed to include a provision that expressly prohibits retroactive application.[52]

74. DPA argues that Staff's brief regarding the 2006 Amendments is irrelevant and cannot override what it believes are the clear provisions of the various WSAs.

75. I agree with Owner that Staff's brief, while certainly not determinative, does provide additional extrinsic evidence as to the prospective application of the 2006 Amendments (which for the first time permitted a utility to "gross up" its tax costs of a CAIC received); however, I do not believe that this fact alone controls the ultimate disposition of this matter.

76. Owner's next argument is that Section 3.8.6 of the Minimum Standards contained Order 6873 only permits - but does not require - water utilities to "gross up" CAIC receipts for the tax effect and leaves in place the previous rule that any CAIC payments received by a utility may be included in its rate base allowing it a return on the investment.

> A CIAC will consist of an amount equal to the entire estimated cost, including the utility's standard overhead costs, of constructing the Facilities Extension. If any portion of property contributed by the contractor, builder, developer, municipality, homeowner, or other project sponsor is deemed taxable income to the utility, the utility shall be permitted to gross up the amount of the CIAC to include such tax liability. (emphasis added)[53]

77. The previous rule permitting a water utility to "gross up" its CAIC and seek inclusion of the cases in its rate base was left in place by Minimum Standards Section 3.8.7.

> The Federal and State income taxes, if required, associated with the CIAC and paid by the utility receiving the CIAC, may be added to rate base, at which time the utility will have an opportunity to earn a fair return on this amount.[54]

[52] Opening Post-Hearing Brief of Staff (filed July 27, 2005)
[53] *Op. cit.* 26 *Del. Admin. Code* § 2001-3.8.6
[54] *Op. cit*. 26 *Del. Admin. Code* § 2001-3.8.7

78. However, both DPA and Tidewater cite specific language in the WSAs which they argue makes the Owner subject to future tariff changes, overrides these sections. I will turn to this argument shortly.

79. Owner's next argument revolves around the word "and" in Section 16(c) of the Woodfield Preserve WSA.

> the parties agree to be bound by the present and future rules and regulations of the PSC, DNREC, the Division of Public Health, and the tariff, rules and regulations of Tidewater and agree to abide by same.[55] (emphasis added)

80. Owner argues that a careful reading of the language cited subjects Owner to "present and future rules, regulations of the PSC, DNREC, and Division of Public Health…" (the words before the word "and") but argues that the prefatory language before the word "and" does not include its agreement to abide by future changes to the words thereafter - "the tariff, rules and regulations of Tidewater…" Owner has also cited *Concord Steel* for support of its position that the word "and" is not conjunctive and therefore the clauses stand separately. According to Owner it has agreed to abide by "future rules and regulations of the PSC, DNREC, the Division of Public Health…" but not necessarily to the future tariff rules and regulations of Tidewater (the provision after the word "and").

81. Tidewater and DPA forcefully argue the opposite - that the language binding Owner to the "present and future rules and regulations of the PSC, DNREC, and Division of Public Health, and the tariff, rules and regulations of Tidewater…" is meant to bind Owner to both – to the future tariff. rules and regulations of Tidewater, as well. Tidewater and DPA cite several cases in support of their interpretation including the same *Concord Steel a*s cited by Owner.[56]

82. I have read and re-read *Concord Steel* cited by the parties as support for their respective positions with respect to its interpretation of the word "and" without coming to a firm view of its application to the current dispute. In my view, the interpretation of

[55] Revised Stipulations, Exhibit F ¶ 16(c).
[56] Tidewater Op. Br at 6,7.

the word "and" in the present matter is ambiguous and thus in the words of *Concord Steel* is subject to "extrinsic evidence" to determine the intent of the parties.

83. As Hearing Examiner, I would hope that a matter of this importance would not turn on a determination of the meaning of the ambiguous (in this matter) meaning of the word "and." Fortunately, I do not believe it needs to. (If it were, my preliminary view would be that Tidewater's and DPA's interpretation, while understandable and not without some merit, would not be sufficient to overcome Delaware law that does not favor giving retroactive effect to contracts.)[57]

84. Tidewater and DPA also rely on the language in the recitals portion of the WSAs that provides "Tidewater is willing to furnish public utility water service to [Woodfield Preserve] pursuant to its rates, rules, and regulations as they presently exist and as from time to time may be amended and filed with the Delaware Public Service Commission."[58] I agree with Tidewater and DPA that this language is instructive and supportive of their positions, but again I do not believe it is determinative.

85. Moving to Owner's final argument, even were I to accept Tidewater's and DPA's interpretation of the meaning of the word "and" in the WSAs and give due weight to the language in the recitals, I do not believe such language is determinative of the matter as I believe the further language in Section 16(c) of the Woodfield Preserve WSA is most relevant.

86. Looking more closely at to the further language in Section 16(c) of the Woodfield Preserve WSA, I ask "Is the 2018 tariff change such a change that makes it 'necessary to make changes or additions to the contemplated or constructed Water Distribution System installation or Production Facilities or in the provisions of this Agreement related to same?'" If Tidewater is permitted (but not required) to "gross up" a CAIC for its tax effect, does that make it "necessary to make changes or additions to the contemplated or constructed water distribution system installation or in the provisions of this Agreement related to the same…?" How does the tax "gross up" make it <u>necessary</u> to make changes or additions to the contemplated or constructed water

[57] See Section 68 above.

[58] Revised Stipulations, Exhibit F (Aydelotte Farm/Woodfield Preserve WSA) at 1 (emphasis added); see also Revised Stipulations, Exhibit J at 1, Exhibit K at 1, and Exhibit L at 1.

distribution system installation? I do not see that it does. This is not about changes necessary with respect to the constructed water distribution system installation. If the tariff change were about the water system distribution system, my view would likely be different. But this is not about the water system distribution system. It's only about money – it's about who pays?

F. Conclusions

87. I conclude that the provision contained in Tidewater's 2018 tariff amendment contained in Order 9812 that requires Tidewater to "gross up" the received CAIC' do not make it "necessary to make changes or additions to the contemplated or constructed water distribution system installation or in the provisions of this Agreement related to the same."

88. With respect to the tax "gross up" of the CAICs, then, I find they are governed by the then-existing (April 9, 2006) provisions of Regulation Docket 15 as contained in Section 3.8.7 of the Minimum Standards that such a tax "gross up" is the responsibility of Tidewater for which it "will have an opportunity to earn a fair return on this amount."

89. I have thought carefully about the protestations of both Tidewater and DPA that concluding that the Owner is not liable for the tax "gross up" of its CAIC in this matter the likely (but not required) effect will be that Tidewater will be able to include these costs in its rate base and earn a return on same as provided in the Minimum Standards contained in Section 3.8.7 thereof. So, the costs could ultimately (likely) be borne by Tidewater's customers. Tidewater's briefs argue forcefully that such an effect would be contrary to the public policy of the Commission as enacted in its Order 6873.[59] I fully understand that this outcome is perhaps contrary to the current policy of the Commission and I understand the reasons why. This is not an issue about which I am unfamiliar. But importantly, that was not the policy of the Commission at the time the WSAs were entered into.

90. In concluding that the language in Section 16(c) of the Woodfield Preserve WSA does not require the Owner to pay the tax "gross up" of the CAIC and its likely effects, I have considered several factors in this matter as follows:

[59] Tidewater Op. Br. at 19-20.

(i) As stated in its Opening and Answering briefs, Owner has pointed out that neither the Woodfield Preserve WSA nor the language in Order 6873 mentioned having a developer pay for future tax "gross ups" to a CAIC when both documents could have dealt with the issue. And it is/was an issue about which all parties were intimately familiar at the time from past matters.

(ii) Tidewater apparently has recently amended its form WSA to deal with the issue of tax "gross ups" with respect to CAICs to make it clear that developers are required to cover such costs. But the new language was not previously included in its WSAs generally nor in the Woodfield Preserve WSA. It could have been.

(iii) The clear language in Section 3.8.9 of the Minimum Standards contained in Order 6873 that the provisions of the 2006 amendments to Regulation Docket 15 would be prospective only.

(iv) The various arguments of Tidewater and the DPA that the language in the various WSAs clearly require the Owner to pay for newly-imposed costs fourteen (14) years after the effective date of the WSAs I find to be a stretch. At best, I have found the language ambiguous, if not tilted in the Owner's favor.

(v) But most importantly in my mind is that Delaware law does not favor retroactive changes to executed contracts. While the policy of the Commission on the tax "gross up" liability of developers has changed, it clearly was not the policy of the Commission when the various WSAs of the Owner were entered into. So, to rely on the ambiguous language in the various WSAs to "rescue the day" strikes me as being a bridge too far and contrary to Delaware law.

91. Putting this all together, I am mindful of a 1993 decision of former Hearing Examiner Padmore (for whom I had the greatest respect – may he rest in peace) in a related Docket 15 decision:

> I recommend that the proposed modification to Rule 3.8.4 should be adopted for prospective application to contracts relating to the payment of advances between

> water utilities and developers. In my view, *it would be inappropriate for the recommended rule modification to apply retroactively to existing contracts between utilities and developers*. Besides being of questionable legality, such retroactive application could, as a practical matter, also pose impossible and unnecessary nightmarish administrative problems for the utilities.[60] (emphasis added)

92. I am not sure giving retroactive effect to a tax change 14 years later would "pose impossible and unnecessary nightmarish administrative problem for the utilities." Nevertheless, I agree (i) that to give retroactive effect to Tidewater's 2018 tariff change by imposing costs on a developer that were never at the time (14 years prior) contemplated (by either party), (ii) that are not clearly contained the various WSAs and (iii) to override a clear provision contained in the 2006 Amendments Regulation Docket 15 that the revised rules were to be prospective only would be unfair, inappropriate and contrary to Delaware law that does not favor retroactive effect of contract provisions, the well-stated arguments to the contrary by excellent counsel to both Tidewater and DPA notwithstanding.

VIII. FINDINGS AND RECOMMENDATIONS

92. For the reasons stated above, I recommend to the Commission the following:

> That the Complaint of Thompson Schell, LLC that it does not owe to Tidewater the tax "gross up" for the various CAICs it paid to Tidewater on account of the Woodfield Preserve development following the 2018 PSC Order No. 9219 amending Tidewater's tariff is AFFIRMED, and that such tax costs are the responsibility of Tidewater (which may be allowed to be included in its rate base subject to the Rules and Regulations of the Commission.)

[60] PSC Regulation Docket 15, 1992 WL 457454 ¶ 40 (Del. P.S.C. Oct. 21, 1992).